Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author:	Dymally	Analyst:	Nicole Kwon	Bill Number:	AB 1134
Related Bills:	See Prior Analysis	Telephone:	845-7800	Amended Date:	January 7, 2008
		Attorney:	Douglas Powers	Sponsor:	

SUBJECT: Medical Enterprise Zones/Medical Enterprise Zone Hiring, Qualified Primary Care Residency Care Residency Program, & Sales & Use Credits

____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended ________________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENTS CONCERNS stated in the previous analysis of bill as introduced/amended ________________.

____ FURTHER AMENDMENTS NECESSARY.

____ DEPARTMENT POSITION CHANGED TO ________________.

__X__ REMAINDER OF PREVIOUS ANALYSES OF BILL AS INTRODUCED February 23, 2007, AND AS AMENDED April 16 & 18, 2007, STILL APPLY.

____ OTHER – See comments below.

SUMMARY

This bill would designate ten new medical enterprise zones (EZs) and allow various credits for activities within those zones.

This bill would make changes to the Government Code related to the medical EZs, including the criteria for being designated as a medical EZ. Discussion in this analysis is limited to those provisions of the bill that affect the Franchise Tax Board (FTB).

SUMMARY OF AMENDMENTS

The January 7, 2008, amendments would add back the provisions designating ten medical EZs that were included in the bill as introduced February 23, 2007, and then removed in the April 18, 2007, amendment.

As a result of the amendments, the “This Bill” and the “Economic Impact” discussions have been revised and are provided below. In addition, the unresolved “Implementation Considerations” identified in the department’s analysis of the bill as introduced on February 23, 2007, and as amended on April 18, 2007, remain and are provided below. Except for the revisions discussed above, the department’s previous analysis of the bill as introduced on February 23, 2007, continues to apply.

Board Position:			Legislative Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Brian Putler	1/10/08
____ N	____ OUA	__X__ PENDING		

POSITION

Pending.

ANALYSIS

THIS BILL

Under the newly designated medical EZs, this bill would create the following credits for taxable years beginning on or after January 1, 2009:

1. A hiring credit for “qualified taxpayers” that hire health care professionals to perform services within a medical EZ. This credit would be calculated the same way as the current hiring credit allowed under existing EZs; a credit of up to 50% of wages paid to “qualified employees” in the first year of employment, decreasing by 10% each year thereafter.
2. A sales or use tax credit for taxes paid or incurred on medical equipment purchased by the taxpayer. This credit would be calculated like the current sales or use tax credit allowed under existing EZs; the credit is for the sales or use tax paid with respect to the total cost of qualified property purchased and placed in service in any taxable year. However, the total costs of qualified property that may be taken into account cannot exceed $1.2 million under the Personal Income Tax Law (PITL) or $20 million under the Corporation Tax Law (CTL) in any particular taxable year. This bill would specify the following:
   - “Qualified taxpayer” means a person or entity engaged in a trade or business that provides primary care services to be used exclusively within a medical EZ.
   - “Qualified property” means medical equipment up to a value of $1.2 million for personal income taxpayers and $20 million for corporate taxpayers.
   - “Medical equipment” is specified under the bill.
3. A qualified primary care residency training program credit of an unspecified percentage for “qualified taxpayers” that engage in providing, arranging, paying for, or reimbursing the cost of personal health care services. This bill would specify the following:
   - “Qualified amount” means the costs paid or incurred by a qualified taxpayer for the support of a qualified primary care residency training program.
   - “Qualified primary care residency training program” means a primary care residency training program located and operating in a medical EZ.

IMPLEMENTATION CONSIDERATIONS

Medical equipment up to a value of $1.2 million for personal income taxpayers ($20 million for a corporate taxpayer) can be interpreted as either $1.2 million in aggregated amounts of equipment or related to the cost of each individual piece of equipment. The author may want to clarify how these amounts would be determined.

The apportionment language in this bill starts with total income rather than California total income currently used in the Geographically Targeted Economic Development Areas. In addition, payroll and property factors necessary to compute income in the medical EZ are not defined. The author may want to amend this bill to refer to the provisions in the current Geographically Targeted Economic Development Areas in the Revenue & Taxation Code.

Department staff currently has no expertise in primary health care services or health practitioners. The author's office may consider having another state agency with expertise in primary health care certify which taxpayers are located in a medical EZ and provide primary care services as defined in the bill. The taxpayer could then be required to provide this certification to FTB upon request.

The bill uses the term "support" on page 18, line 37 and page 30, line 23, which should be defined. The bill provides no requirement that "support" be measured in direct relation to the physical operations inside a medical EZ.

The definition of "qualified taxpayer" should be clarified. For example, it is unclear if the author's intention is to include an insurance company as a "qualified taxpayer." The absence of clarification for this term could lead to disputes with taxpayers and would complicate the administration of this credit.

The term "a primary care residency training program" should be defined. The absence of a definition for this term could lead to disputes with taxpayers and would complicate the administration of this credit.

The bill specifies that the hiring credit is for employees hired after entering the medical EZ. The bill fails to clarify how existing employees of a medical EZ will be accounted for when it is incorporated into the medical EZ. The taxpayer could terminate those employees and rehire them the next day to qualify for the credit. The author may wish to amend the bill to clarify how existing employees would be treated.

This bill would allow first year employees a 50% tax credit for the taxpayer assuming the employee remains employed with the taxpayer for five consecutive years. It is unclear how a first year employee will be treated if that employee works for a few months qualifying the taxpayer for the 50% hiring credit, is terminated a few weeks later, and then rehired. It appears the taxpayer would be able to start the wage credit cycle over again when the employee is rehired. The author may wish to amend the language to clarify how terminated and rehired employees within a specific timeframe will qualify. The existing enterprise zone hiring credit contains language that addresses this situation in R&TC section 17053.74(e) and R&TC section 23622.7(e), which may be used as a model for language to address this implementation consideration.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Revenue Estimate for AB 1134 Effective for Tax Years BOA January 1, 2009 Assumed Enactment Date after June 30, 2008			
Medical EZ	2009-10	2010-11	2011-12
Hiring credit	-<$500K	-<$1.5M	-$1.5M.
Sales or use tax credit	-<$500K	-<$2 M	-$2.5M.
Residency training program credit	Unknown	Unknown	Unknown

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

The revenue loss associated with the residency training program credit is unknown because the percentage of credit amount allowed is unspecified.

Revenue Discussion

This bill would provide three credits for designated medical EZs: (1) hiring credit for health care professionals, (2) sales or use tax credit for qualified medical equipment, and (3) primary care residency training program credit. This bill specifies credit amounts for the first two as a percentage of paid wages or the amount of paid sales or use tax on each piece of equipment, valued up to $1.2 million for personal income taxpayers or $20 million for corporate taxpayers. The creditable amount of primary care residency training program is unspecified and therefore the total revenue loss from this bill is unknown.

Hiring Credit:

The revenue impact of the hiring credit is dependent on the amount of wages paid during a year and the number of medical professionals hired to perform services within a medical EZ.

The medical EZ designation may be in an unincorporated or incorporated area. If the medical EZ is within an incorporated area, it must be designated as a Health Professional Shortage Area. For calendar year 2006, the U.S. Department of Health and Human Services (DHHS), designated 18 counties within California as Health Professional Shortage Areas (HPSA) of primary medical care. This database provides the number of full-time equivalent positions needed for designation. This number of positions does not represent the total number of anticipated employment in the area, such as other medical support services needed to maintain varied levels of care. Therefore, the total number of new jobs per medical EZ is dependent on each area’s established network of available medical services/resources.

Based on DHHS data about HPSA designations, this estimate assumes that the 18 counties identified are potential medical EZs and that the top ten facilities with the greatest shortage are selected as medical EZs. The number of full-time equivalent positions identified by the DHHS for these 10 designated county areas is 80 positions. This number of positions is tripled to account for an increase in related medical support services within the medical EZs, resulting in approximately 240 new positions within all medical EZs. Applying the wage limit of (150% of the minimum wage) or $12 per hour ($8 minimum wage as of 1/1/08 x 150% = $12), total eligible wages for full-time employment would total approximately $5.9 million (240 positions x 52 weeks/year x 40 hour work week x $12/hour).

Of the eligible wages paid, for the first year of employment, the creditable amount is 50%; this percentage reduces by 10% for each subsequent year of employment (40% for year 2, 30% for year 3, 20% for year 4, and 10% for year 5). By applying this wage limit, hiring credits are approximately $3 million for 2009 ($5.9 million X 50%). Total credits for 2009 are reduced to $2.7 million to adjust for the amount of deductions that, absent this proposal, would have been reported under current law. Eligible wages for 2010 would include approximately $2.5 million ($5.9 million x 40%), which is 40% of wages paid for employees hired in 2009 plus 50% of wages paid for employees hired during 2010. This estimate assumes that employment grows at 5% within each medical EZ for current law deductions, bringing total credits for 2010 to approximately $2.3 million.

Sales or Use Tax Credit:

The revenue impact of the sales or use tax credit is dependent on the amount and the value of equipment placed in service within a medical EZ.

Assuming that, on average, total expenses for equipment per medical EZ for each professional identified by DHHS is $600,000 per year for 3 years and that 80% or $480,000 ($600,000 x 80%) qualifies, the creditable amount are sales or use taxes paid on this amount. Assuming a sales or use tax rate of 7.75%, the annual credit would result in total losses of approximately $3.7 million for all medical EZs, for three-years ($600,000 x 80 positions x 7.75%). Total credits are reduced to $3.4 million to reflect the provision that would deny a deduction for the same expense.

Summary:

Based on the assumptions presented above, the combination of the hiring credit and the sales or use tax credit for taxable year 2009 would total approximately $6.1 million ($2.7 million in hiring credit + $3.4 million in sales or use tax credit), $5.7 million for 2009 ($2.3 million in hiring credit + $3.4 million in sales or use tax credit) and $5.3 million for 2010.

The chart above assumes that the approval process and the designation of all medical EZs would be made during the later part of 2009 and therefore only 10% of the losses derived for 2008 would be realized. Unused medical EZ credits would be carried over until exhausted. This estimate assumes that 60% of credits generated during a year would be used and the remaining would be carried over for three-years. The revenue estimate in the chart above reflects these assumptions and anticipated changes in estimated tax payments.

POLICY CONCERNS

This bill lacks a sunset date. Sunset dates generally are provided to allow periodic review of the effectiveness of the credit by the Legislature.

This bill allows an unlimited carryover period. Consequently, the department would be required to retain the credit on the tax forms indefinitely. Recent credits have been enacted with a carryover period limitation; experience shows credits are typically exhausted within eight years of being earned.

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